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CITATIONS

Case:

Bonwit Teller & Co. v. *Commissioner*, 53F. (2d) 381, certiorari denied, 284 U. S. 690 — 7, 8

Statutes:

Revenue Act of 1934, c. 277, 48 Stat. 680, Sec. 23 — 2

Revenue Act of 1936, c. 690, 49 Stat. 1648, Sec. 23 — 2

494554—42



In the Supreme Court of the United States

OCTOBER TERM, 1942

No. 502

PHILADELPHIA COKE COMPANY, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 20–21) is not reported. The opinion of the Circuit Court of Appeals (R. 23–29) is reported in 130 F. (2d) 87.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered July 29, 1942 (R. 29). The petition for a writ of certiorari was filed October 29, 1942. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Under a contract to supply gas to the assignee of a lease of a municipally owned gas works, petitioner built a gas main through which a part of the gas was to be supplied. Under the contract title to the main vested in the assignee of the lease. Under Section 23 (l) of the Revenue Acts of 1934 and 1936, should the cost of the main be amortized on the basis of the stated term of the contract or on the basis of a shorter period, measured by the earliest date as of which the lease of the gas works could be terminated, the stated life of the contract being dependent upon the nontermination of the lease during that stated term?

STATUTES INVOLVED

Revenue Act of 1934, c. 277, 48 Stat. 680:

> SEC. 23. DEDUCTIONS FROM GROSS INCOME.
>
> In computing net income there shall be allowed as deductions:
>
> * * * * *
>
> (l) *Depreciation.*—A reasonable allowance for the exhaustion, wear and tear of property used in the trade or business, including a reasonable allowance for obsolescence. * * *

The provisions of Section 23 (l) of the Revenue Act of 1936, c. 690, 49 Stat. 1648, are identical with those set out above.

STATEMENT

The City of Philadelphia owned a plant for the manufacture of gas which, in 1897, it leased to The United Gas Improvement Company (hereinafter referred to as "United") for a 30-year term ending December 31, 1927. During the term of that lease United operated the plant and facilities, supplying gas to consumers in Philadelphia and its suburbs. (R. 4.)

In 1926 the city and United entered into a new agreement whereby the plant was again leased to United for an indefinite period beginning January 1, 1928, with the right in the city to terminate the lease on December 31, 1937, or at the expiration of any 10-year period thereafter, upon giving certain notice and reimbursing United for expenditures made for improvements and additions to the gas works. United also had the right to terminate the lease on December 31, 1937, or at the expiration of any 10-year period thereafter upon giving due notice. (R. 4–6.)

In December 1927, United assigned the lease to The Philadelphia Gas Works Company (hereinafter referred to as "Gas Company"), its wholly owned subsidiary, with the approval of the city (R. 6).

In January 1928, petitioner contracted with the Gas Company to erect a plant for the conversion of coal into gas and to sell the gas to the Gas Company. This contract, which was approved by the

city, was for a stated term of 30 years, subject, however, to earlier termination if the contract between the city and the Gas Company, as assignee, were terminated. In January 1929, in a supplemental agreement with the Gas Company, petitioner agreed to construct a gas main from its plant to one of the plants of the Gas Company, title to the main to vest in the Gas Company. This gas main was completed and put into service on or about January 1, 1930, at a cost to petitioner of $692,985.27. (R. 6–8, 14–16.)

On March 13, 1936, the Mayor of Philadelphia, pursuant to a city ordinance, notified United and the Gas Company of the city's intention to terminate the leasing agreement as of December 31, 1937. On April 7, 1936, the Gas Company notified petitioner that because of the Mayor's notice the agreement between them would also terminate as of December 31, 1937. However, on December 29, 1937, the city council passed over the Mayor's veto an ordinance directing that the city make a new lease with the Gas Company for a term beginning January 1, 1938. The ordinance also directed that the new lease embody an agreement that the existing lease be terminated as of December 31, 1937, and a provision that the contract between the Gas Company and petitioner should not be extended beyond December 31, 1937. On December 30, 1937, the Mayor threatened to take possession of and operate the gas works. To

forestall that action the Gas Company on the following day instituted a suit to enjoin the Mayor and the city from terminating the 1926 lease, and a restraining order was obtained *pendente lite.* (R. 8–9.)

On December 30, 1937, petitioner entered into a temporary agreement with the Gas Company to continue to furnish gas for the six-months' period ending July 1, 1938. This agreement was extended for 15 days on July 1, 1938. (R. 9.)

On June 30, 1938, the Supreme Court of Pennsylvania rendered a final decision (331 Pa. 321, 1 Atl. 2d 156) enjoining the Mayor and the city from interfering with the Gas Company's peaceful possession of the gas works. The principal ground of the decision was that, although the 1926 lease agreement could have been terminated by the city on December 31, 1937, upon compliance with the conditions of the agreement, the termination had not been effected because of the failure of the city to reimburse the Gas Company for expenditures made for improvements and additions to the gas works. (R. 9–10.) [1]

Following that decision, the temporary agreement between the Gas Company and petitioner was cancelled, and a retroactive agreement dated July 15, 1938, was substituted, covering the period January 1, 1938 to January 15, 1939 (R. 11).

[1] The court held (R. 10): "That such payment not having been made the lease was not terminated and is still in force."

On October 5, 1938, the city council entered into an agreement with the Gas Company which provided that the 1926 lease should be terminated as of December 31, 1937; that the contract between the Gas Company and petitioner should not be extended beyond December 31, 1937; and that with the approval of the city the Gas Company should have the right to purchase gas from other parties, in substitution for or to supplement gas which would otherwise be produced at the gas works (R. 11).

Thereafter, several additional agreements were entered into between petitioner and the Gas Company, extending the agreement of July 15, 1938, to March 31, 1940. Then, by an agreement dated April 1, 1940, the Gas Company contracted for the supply of gas by petitioner for a period of five years from April 1, 1940, and thereafter from year to year unless and until terminated. That agreement was approved by a city ordinance dated April 16, 1940. (R. 11–12.)

In its income tax returns for 1934 and 1936, petitioner claimed as deductions a proportionate part (approximately $\frac{1}{28}$th) of the cost of the gas main, on the ground that the cost should be amortized over the period from January 1, 1930, to December 31, 1957. The Commissioner allowed those deductions. However, during the course of the negotiations leading to the agreement between petitioner and the Gas Company

on April 1, 1940, petitioner prepared claims for refund for 1934 and 1936 on the ground that its property right in the original contract with the Gas Company was terminable at the end of eight years and that the cost of the gas main should, therefore, be amortized over the eight-year period. These claims for refund were filed on March 11, 1938, and March 14, 1940, respectively. (R. 12–13.)

The Board of Tax Appeals held (R. 20–21) that the cost of the gas main should be amortized over the period ending December 31, 1937, the earliest date as of which the city could terminate the 1926 lease. The court below reversed the Board (R. 23–29), holding that the depreciation claimed in petitioner's returns and allowed by the Commissioner for 1934 and 1936 for the amortization of the cost of the gas main over the term stated in the 1928 contract between petitioner and the Gas Company was correct.

ARGUMENT

Although petitioner urges that the decision below conflicts with *Bonwit Teller & Co.* v. *Commissioner,* 53 F. (2d) 381 (C. C. A. 2), certiorari denied on another issue, 284 U. S. 690, the two decisions are in complete accord, as the opinion below itself evidences.

The *Bonwit Teller* case was in substance the converse of the instant case, in that there the property to be depreciated was a leasehold for a fixed term subject to renewal at a rental to be then

determined, whereas here the property to be depreciated is the right to use a gas main for thirty years subject to a possibility of earlier cancellation. In each case there is a fixed period of use, subject to alteration in the event a contingency occurs. In each case the decision was that the property is to be depreciated over the fixed period and the possible alteration of that period by the happening of the contingent event is to be ignored. The decisions are thus wholly consistent.

Petitioner's contention to the contrary is based on a theory which would treat a lease for ten years subject to a right of renewal for ten years, as being the same thing as a lease for twenty years subject to cancellation at the end of ten years. It seems manifest that the two leases are not the same at all, since wholly different results will obtain under the two leases if (1) the contingency in each lease fails to occur or (2) the contingency in both leases occurs. Petitioner's theory is sound only if we assume that in one case but not the other the contingency will occur. There is no basis for such an assumption. As both the instant case and the *Bonwit Teller* case refuse to assume that the contingencies will occur, they are consistent and both are contrary to petitioner's position.

CONCLUSION

The decision below is correct and there is no conflict. The petition should be denied.

Respectfully submitted.

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